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The Manufacturers Hanover
Financial Digest
Weekly Commentary, Selected Financial Data, and Business Indicators

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Monetary Policy . . .

With the business recovery now settling into a slower, albeit more sustainable pace and few, if any, signs on the horizon of an imminent reacceleration in the rate of inflation, last week's meeting of the Federal Reserve's policy-setting Federal Open Market Committee confronted few imperatives for altering monetary policy. Rather, unfolding business and financial developments suggest the need for quite the opposite: Keeping monetary policy in a holding pattern until such time as it does seem that the recovery is faltering or inflation expectations are reviving.

Indeed, Fed Chairman Paul A. Volcker's testimony before Congress this week is expected to contain few surprises for the financial markets. He will undoubtedly re-emphasize the need to curb Washington's ongoing financial profligacy, a task underscored by the just-released fiscal 1985 budget, and will probably reaffirm the tentative 1984 money supply growth targets set last summer. However, while monetary policy will hold steady for now, prospects are brightening that a tilt toward accommodation will occur soon, in part to give today's business expansion a modest fillip, and in part a response to the vocal chorus of critics concerned about the flattening of M1 money growth which took place in the latter part of 1983.

One area of encouragement for the Fed, not to mention the credit markets, has been the recent deceleration in business activity. Retail sales, production and capacity utilization data all point toward a slowing of the growth momentum, typical of a business recovery early in its second year. What is more, the subdued 0.6 percent month-over-month rise in the December index of leading economic indicators suggests that a further moderation in the pace of business activity is likely in the months ahead. Again, however, this is not unusual; as shown in the chart, this index usually begins to flatten out at about this stage of the business cycle.

. . . Will Remain In A Holding Pattern . . .

On the other hand, one thing that is not about to flatten is Washington's credit appetite. Quite the contrary. Whereas Treasury borrowings usually began to taper off at this stage of past recoveries as tax receipts swelled and counter-cyclical outlays diminished, the usual post-recession dip in Federal credit needs will not take place this time around. This is because the Administration now expects on-budget deficit totals in excess of $180 billion in this fiscal year and fiscal 1985 (on the heels of a $195 billion red ink total in fiscal 1983), virtually ensuring that Washington will continue to absorb a

INDEX OF LEADING INDICATORS:
CURRENT RECOVERY (LINE)
VS. AVERAGE OF PRIOR 7 RECOVERIES (DOT)
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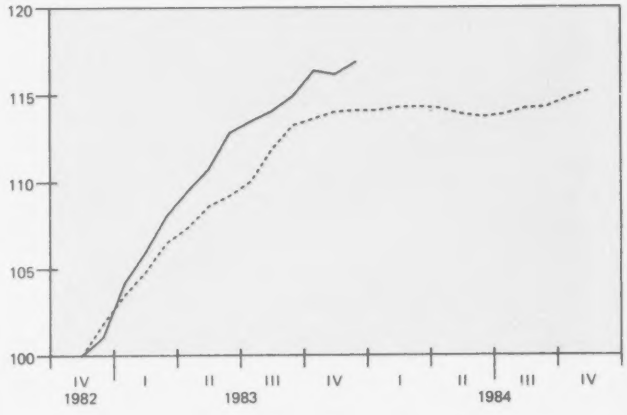

cyclically abnormal proportion of funds raised in the credit markets. In the past, Treasury borrowings would usually slip to an average of less than $1 for every $10 raised in the debt markets by the second year of recovery; in the current fiscal year, $1 in every $3 raised is expected to go to the Treasury—not far from the the fiscal 1983 proportion of just about 37½ percent.

Thus, public and private borrowings may well collide later this year once corporate America returns in force to the credit markets. But with business cash flow still rebounding sharply, such a clash is unlikely to occur soon. However, this does not mean it never will, and this is precisely why the flexibility of monetary policy remains hamstrung by

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the persistence of these 12-digit budget deficits. To ease the monetary reins now would run the risk of ultimately more inflation and higher, not lower interest rates; with a robust, noninflationary recovery underway, the Fed will remain reluctant to alter policy significantly.

This is why Chairman Volcker will probably stress the need for substantive deficit reductions before monetary policy can turn overtly accommodative and interest rates descend from their lofty levels. For the money supply in 1984, this means that the money growth targets set last summer will most likely be reaffirmed. These targets, together with a somewhat more rapid turnover rate, should be sufficient to keep the recovery on track, on the one hand, but not so overly generous that they would reignite inflation expectations, on the other. And, since all the money supply measures are currently expanding within their current target boundaries, few modifications of existing policy appear necessary.

. . . At least A While Longer

So, too, another reason for holding policy steady is the heightened uncertainty, and potential for increased interest rate volatility, surrounding the

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 1/25/84	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	159.957	– .500	+16.974
Loans to Depository Inst.	.505	– .279	+ .180
Float	1.495	+ .105	– 1.099
Total Reserve Bank Credit	170.825	– .508	+14.840
Treasury Deposits with Federal Reserve Banks	5.252	+ 2.134	+ 1.343
Currency Outside Banks	146.117	– 1.455	+12.622
Member Bank Reserves:			
Required	39.672	– .887	– 1.350
Excess (Deficiency)	.636	+ .026	+ .135
Total Reserves Held	40.308	– .861	– 1.215
Net Free Reserves	.233	+ .324	– .174
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	111.733	– .386	+ .371
Monetary Aggregates†		**% Change Since Three Months Ago***	**% Change Since Year Ago**
M1	521.8	+ 4.1‡	+ 8.8‡
M2 (December '83)	2,184.6	+ 7.3	+ 11.5
M3 (December '83)	2,599.8	+ 8.8	+ 9.3
Domestic Nonfinancial Debt (3rd Q'83)	5,072.0	+ 11.2	+ 10.4

†Seasonally adjusted.

*Seasonally adjusted annual rate.
‡Four-week moving average.

New York Money Market

Offering Rates 2/3/84	3 Months	6 Months	1 Year
‡U.S. Treasury Bills	8.65%	8.70%	8.75%
* Federal Agencies	8.70	9.00	9.35
* Project Notes–Taxfree (46% Taxable Equivalent)	9.07	9.26	10.00
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market–Prime	9.33	9.43	9.85

‡Finance Company Paper–Prime

5- 14 days	9.30%
15- 29 days	9.30
30- 59 days	9.30
60- 89 days	9.15
90-179 days	9.05
180-239 days	8.80
240-270 days	8.80

‡* Bankers' Acceptances

Mar.	9.18%
Apr.	9.18
May	9.18
Jun.	9.18
Jul.	9.18
Aug.	9.15

‡Industrial Paper–Prime

30- 89 days	9.20%
90-120 days	9.15

†Federal Funds Effective Rate 9.50%

‡Discount basis. * Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	4th Q'83	$ 3,432	$ 3,362	$ 3,110
Gross National Product (1972 Dollars)*	4th Q'83	$ 1,571	$ 1,553	$ 1,481
Percent Change, Annual Rate	4th Q'83	4.5	7.6	– 1.3
Change in Consumer Prices (new series)*	Dec '83	3.6%	3.6%	– 3.6%
Change in Producer Prices*	Dec '83	2.4%	– 2.4%	3.6%
Civilian Employment (Thousands of Persons)†	Jan '84n	103,190	102,941	99,154
Unemployment as % of Civilian Labor Force†	Jan '84n	8.0%	8.2%	10.4%
Personal Income*	Dec '83	$ 2,857	$ 2,833	$ 2,645
Leading Indicators Composite Index (1967=100)†	Dec '83n	162.9	161.9r	140.9
Industrial Production Index (1967=100) †	Dec '83	156.9	156.1	135.2
Net Change in Consumer Installment Credit †	Nov '83	$ 4.67	$ 4.89	$ 2.02
U.S. Merchandise Trade Balance †	Dec '83	–$ 6.30	–$ 7.40	–$ 3.66
Plant and Equipment Expenditures*	1st Q'84	$323.07(a)	$321.60(a)	$293.03
Private Housing Starts (Thousands of Units)*	Dec '83	1,667	1,755	1,280
New Construction Expenditures*	Dec '83n	$ 275.0	$ 275.5r	$ 240.2
Total Business Inventories †	Nov '83	$ 518.0	$ 516.0	$ 513.9
Total Business Sales †	Nov '83	$ 387.2	$ 382.2	$ 338.7

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. r-Revised. a-Anticipated.

switch from lagged reserve accounting to contemporaneous reserve requirements. Under the former procedure, even when banks knew precisely their required reserve needs at the beginning of each statement week, and the Fed was aware of the entire system's needs, there was still substantial volatility in the Federal funds market. Under the new procedures, neither holds true, and the shake-down period may be a long one. In coming months, shifts in net borrowed and excess reserves may well reflect more the difficulties that the banks may encounter in estimating accurately their reserve needs (not to mention the Fed's in estimating systemwide needs), rather than any changes in the thrust of Fed policy.

While Fed policy should hold steady until further evidence accumulates that economic growth is slowing, this may be sooner than is generally thought. Unless consumer spending suddenly strengthens, capital spending, hobbled by today's lofty pattern of interest rates, and soggy exports suggest that the next move by the central bank will be toward ease. And since it will occur behind the smokescreen of the switch in reserve accounting, the central bank's inflation-fighting credibility will be maintained. All in all, look for another deft Fed move soon which will keep the recovery solidly on track and inflation expectations derailed. H

Short Term Paper Outstanding

(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Time Deposits of $100,000 or more Weekly Reporting Banks			
Nationwide (1/18/84)	143,580	– 3,192	–30,337
New York City (1/18/84)	29,242	– 1,537	–14,095
Commercial Paper (1/18/84)	185,097	+ 1,157	+18,823

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (1/18/84)	221,165	– 208	NA*
New York City (1/18/84)	58,051	– 152	NA*

Total Loans and Leases Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (1/18/84)	571,558	– 771	NA*
New York City (1/18/84)	129,094	– 38	NA*

*Year ago data not available due to definitional changes.

Financial Markets

	Friday 2/3/84	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	8.97%	– .28	+ .44
180-Day Bills†	9.24	– .36	+ .42
Longest Bills	9.51	– .32	+ .41
Recent Issues:			
10⅝s 1/31/86	10.55	+ .05	
11¼s 12/31/87	11.10	–0–	
11¾s 11/15/93	11.60	–0–	
12s 8/15/13	11.70	–0–	
Municipals:			
Bond Buyer–20 Bond Index* (2/2/84)	9.51%	– .08	– .23
Blue List Total ($ Million)	$1,291	+ $ 15	+ $456
30-Day Visible Supply ($ Million)	$1,695	+ $378	– $231
Total	$2,986	+ $393	+ $225
Corporates:			
Moody's Aa Composite (2/2/84)	12.62%	– .07	– .03
30-Day Visible Supply ($ Million)	$ 812	– $122	+ $262
Stocks:			
Dow-Jones Averages:			
Industrials	1,197.03	– 32.97	+ 119.12
Transportation	535.37	– 31.78	+ 50.30
Utilities	131.89	– .77	+ 6.84
65 Stocks	472.75	– 15.98	+ 44.32
Standard and Poor's 500 Stocks	160.82	– 3.12	+ 14.68
N.Y.S.E. Composite Index	92.98	– 1.78	+ 8.69
N.Y.S.E. Avg. Daily Vol. for Week (000's)	108,982	+ 6,264	+ 30,322

* 46% Taxable equivalent 17.61%.

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 2/3/84	Week Ago
Overnight	9.63%	9.38%
1 month	9.63	9.56
3 month	9.75	9.69
6 month	9.94	9.88
1 year	10.31	10.25
EURODOLLAR BONDS Average Yield		
Medium Term (5 to 7 yrs.)	11.40%	11.45%
Long Term (7 to 15 yrs.)	11.60	11.65

FOREIGN EXCHANGE SPOT RATES

New York Opening (2/3/84)	U.S. $ Equivalent	Currency Per U.S. $
Belgium	.01776	56.31
Canada	.8025	1.2461
Denmark	.10048	9.9525
France	.1184	8.4475
Germany	.3637	2.7495
Italy	.0005921	1689.00
Japan	.004289	233.15
Mexico	.006024	166.00
Netherlands	.3222	3.1033
Switzerland	.4524	2.2105
U.K.	1.4248	.7019

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